

**DRAFT  
REPORT**

**LOCAL GOVERNMENT  
REFORM  
IN BULGARIA  
CURRENT ISSUES,  
CONSTRAINTS &  
OPPORTUNITIES**

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**ABSTRACT (To be developed)**

## EXECUTIVE SUMMARY

This report achieves four principal objectives:

1. Provide a comprehensive diagnostic evaluation of current legal, institutional, administrative, and financial conditions affecting local governments in Bulgaria.
2. Develop a plan for short-term improvements in revenue enhancements and expenditure reductions and/or cost avoidance that can be accomplished without any change in existing legal or institutional requirements currently prescribed by the central government and that can be replicated and disseminated to other Bulgarian municipalities.
3. Develop a plan for application in any Bulgarian municipality for assistance that will produce long-term improvements in financial management, administrative performance, service delivery, and citizen participatory processes. These improvements, however, may necessitate changes in legal/institutional requirements imposed by the central government, if benefits from the improvements are to be realized.
4. Identify pre-feasibility capital projects for each city in the study that demonstrate strong potential for further feasibility analysis and the possibility of funding and implementation assistance from public/private donor agencies.

The local governments included in this study are those of Blagoevgrad, Bourgas, and Rousse. Also participating were officials from the Ministries of Finance and Regional Construction and Development. The officials from the local governments and the ministries are listed in Appendix J. Their cooperation, enthusiasm, and commitment to implement acceptable recommendations for the improvement of local self-government were unequivocally outstanding.

This report complements the findings from the report prepared by KPMG for the World Bank, *The Decentralization of Local Government in Bulgaria*. It is the opinion of the consulting team that these two reports provide the factual and strategic framework and context for a long-term assistance program for local government reform in Bulgaria.

The Constitution of the Republic of Bulgaria considers the municipality a core element of local administration within the legal framework of the Constitution. Article 5 of the Local Self-Government and Local Administration Act (LSGLAA) states that "the Bulgarian municipality is a principal administrative and territorial unit where local self-government is exercised." Yet, the consulting team found little evidence that local self-government as envisioned and expressed by the Constitution and this Act was occurring. However, positive action did occur on July 5, 1994, with an amendment to the Council of Ministers Decree No. 69 wherein municipalities were given authority to establish certain fees and charges for services within upper and lower limits. This new authority is described in Appendix K.

With the exception of the recent amendment mentioned above, the central government has complete control over the character of the taxes, fees, and charges impose the rate of tax and level of fees and charges and the collection and disposition of the revenue. The central government also prescribes the "norms" for the spending plan which may or may not reflect the needs of the citizens and elected officials of the municipalities.

The budget process is used principally as a negotiating tool between the local governments and the central government to determine the amount of subsidy for the municipalities. Budgets are prepared manually with a format established by the Ministry of Finance. Accounts are uniformly coded, and precise requirements are set forth for completing and reporting on the budget process. The budgeting methods used to allocate governmental revenue and expenditures are determined by the MOF, which also sets specific standards and targets for all expenditure and revenue categories that are given in the annual budget instruction. This is described in Chapter 2.2.

The accounting system described in Chapter 2.3 is based on cash transactions and, therefore, does not reflect accurately current financial or economic activity, nor does it account for payables and receivables and the level of uncollectible revenue.

The principal revenue sources are described in detail in Chapter 3, with graphic illustrations in Appendix O. The income tax is the largest source of municipal revenue, but the current allocation to municipalities is diminishing. Initially, the tax revenue was entirely assigned to municipalities; in 1992 the allocation became 30% for the central government and 70% for the municipalities; in 1993 the allocation was modified to 50% for the municipalities. The turnover tax was being paid by businesses on the sale of goods and provided about 15% of local revenue. However, on April 1, 1994, the value added tax (VAT) was enacted and replaced the turnover tax; the revenue proceeds go entirely to the central government. The real estate and property tax currently provides minimal revenue, but could be a substantially important source, if the Local Property Tax and Rates Bill (described in Appendix L) now before Parliament passes. It would allow a valuation method based on market principles rather than gross area and allow the municipalities to establish and adjust the rate of taxation.

While the principal expenditure categories for municipalities prescribed by the central government include science and education; culture and arts; health care; construction and development; social support services; tourism and sports; land division and marking; and youth activities, 70% of the expenditures go to education and health. Accordingly, the consulting team concentrated most of its attention to these areas. Appendix G illustrates the cumulative expenditure budgets for the three cities. As has been stated above, the municipalities have virtually no authority or flexibility to develop a spending plan based on local needs or preferences.

Chapter 4 provides recommendations for revenue enhancements, expenditure reductions, and/or cost avoidance which can be accomplished without any change in existing legal/institutional requirements imposed by the central government. Moreover, while the team recommends a specific project to be undertaken within a specific municipality, these improvements can be replicated and disseminated to any municipality in Bulgaria.

Recommendations for revenue enhancements include: a) perform a cost of service study for municipal services related to the management of building permits; b) revise property tax rolls to add property not now

recorded; c) create a financing mechanism for capital improvements of municipal property; d) install a computerized real estate system; e) create a system for registering and monitoring commercial activity of small businesses; f) provide technical assistance for improving the municipal information system; g) establish rate setting capability, billing and collection capacity, and credit criteria for financing a wastewater treatment facility for an unserved portion of Bourgas; h) develop a system for the accounting and management of municipal assets; i) computerize personal income tax records for individuals and sole-proprietor businesses.

Recommendations for expenditure reductions and/or cost avoidance include: a) develop management techniques for current repairs to educational facilities; b) develop software to computerize medical records; c) develop a system of asset management and methods for analyzing educational building systems and structural problems caused by defective material and workmanship.

Chapter 5 recommends long-term improvements applicable to any municipality. However, for optimum benefit, changes in legal/institutional requirements may be necessary. Recommended improvements include: a) revise the accounting system to incorporate accrual accounting methods; b) revise the operating budget process and format to allow the budget to be useful as a decision-making tool for elected and appointed local officials, a financial tool for management and accountability, and a communication tool for increased citizen understanding and support of local priorities; c) implement a capital budgeting process and format that will allow capital investment priorities to be made on a rational basis and with the clear identification of methods for project financing; d) develop a cash management system; e) conduct a cost of service analysis in order to establish a rational basis for setting fees and charges for services with the objective of full cost recovery for the service; f) conduct a health care system analysis in order to effectively coordinate the medical services provided by the regional hospitals, the military hospital, and the Ministry of Transportation's hospital; g) conduct a service delivery analysis on selected municipal activities in the area of education and street maintenance in order to improve the allocation of resources and the measurement of expected performance outcomes; h) implement various



techniques to improve the democratization of the political process and to strengthen the citizen participatory and advocacy processes.

Chapter 6 identifies several pre-feasibility capital projects which the consulting team has concluded have merit for further feasibility analysis.

## 1. INTRODUCTION

This report responds to USAID Request for Services 94 and is based upon a review of documents, interviews, observations, and their analyses, from two site visits in three Bulgarian municipalities: Rousse, Bourgas, and Blagoevgrad. The principal objectives for this project required that the consulting team:

1. Conduct a comprehensive diagnostic evaluation of current legal, institutional, administrative, and financial conditions affecting local governments in Bulgaria.
2. Develop a plan for each city that will produce short-term improvements in revenue enhancement and expenditure reductions that can be accomplished without any change in existing legal or institutional requirements currently prescribed by the central government. Moreover, these improvements must be capable of replication and dissemination to other Bulgarian municipalities.
3. Develop a plan for application in any Bulgarian municipality for assistance that will produce long-term improvements in financial management, administrative performance, service delivery, and citizen participatory processes. It is understood that these improvements, for optimum benefit, may necessitate changes in legal/institutional requirements imposed by the central government.
4. Identify pre-feasibility capital projects for each city that demonstrate strong potential for further feasibility analysis and the possibility of funding and implementation assistance from public/private donor agencies.

This report meets or exceeds the above objectives and other conditions specified in RFS 94. Factual issues have been confirmed, and all recommendations for further actions are distinguished between those possible within current legal/institutional limitations imposed by the central government and those which will require modifications to such to effect optimum benefit for the local governments and the citizens. Moreover, this report has considered in full measure, and complements the findings from, the report prepared by KPMG for the World Bank, *The Decentralization of Local Government in Bulgaria*. It is the opinion of the

consulting team that these two reports provide the factual and strategic framework and context for a long-term assistance program for local government reform in Bulgaria.

The cooperation received from the officials and staff within the three municipalities and representatives from the Ministries of Regional Development and Construction (MRDC) and the Ministry of Finance (MOF) was outstanding. Documents and data were readily available to the team and staff time was willingly made available, which optimized the team's productive time within each municipality. Such cooperation; energy; and the willingness to innovate, perhaps take a risk, and attempt creative approaches are essential for the success of this project. Also required are a high level of effective communication and understanding among the municipalities, the ministries, and the consulting team to design and effect workable solutions. It is indisputably clear that while accountability for delivering services and implementing capital investments rests with the municipal governing bodies and the mayors, the authority and responsibility to fund services and projects rest principally with the central government and the Council of Ministries. Accordingly, any effective change needed to strengthen local self-government will require the cooperation, collaboration, and effective communication among the municipalities and the central government. The officials at the local and central level have a historic opportunity to design and implement the essential elements of democratic local self-government, which is essential for the efficient operation of a market economy. This report is intended to contribute to this important objective.

The methodology employed throughout this project has five components:

1. Each member of the team submitted a list of documents/information needed for review prior to each site visit. These requests were given to Dimitar Doukov, ICMA's local consultant in Sofia, and Anatoli Beltchev, ICMA's consultant from the office of Deloitte & Touche in Sofia, which has a subcontractual relationship with ICMA. Mr. Doukov and Mr. Beltchev made contact with each of the cities by telephone and made on-site visits to gather the material and establish interviews with key personnel. Lists of collected documents with respect to municipal

finance legal environment, on both the state and municipal level, are available in Appendix D and Appendix E, respectively.

2. The translated documents and information were available to the consulting team upon arrival. This established a productive foundation of information for the team which optimized the effectiveness of time on-site. The legal environment with respect to local self-government and local administration, as well as the Bulgarian accounting policies and procedures, were studied carefully.
3. The consulting team conducted two on-site visits, each with a duration of 2-3 days, and reviewed documents, interviewed key personnel, and toured the municipalities to develop the diagnostic description of each municipality, answer questions, address pertinent issues, develop questions for further investigation, and determine appropriate technical assistance and potential capital investment projects.
4. After completing the first on-site examination, the consulting team met with AID and World Bank officials to present initial findings and discuss technical assistance prospects. As a result of these meetings, a list of short-term and long-term improvement assistance projects was compiled.
5. The team visited the three municipalities again to confirm initial findings, answer additional questions, and discuss in detail proposals for specific improvement projects. These discussions resulted in specific recommendations for both short-term and long-term projects at each site. These projects were designed to address specific needs at each municipality and to be applicable and easily transferable to other municipalities in Bulgaria facing similar problems. The municipalities discussed the process in detail with team members and selected what they deemed important and feasible. Each municipality submitted a letter describing the projects and expressing the local government support for the program. The projects for technical assistance are described later in this report.

## 2. DESCRIPTION OF THE CURRENT CONDITIONS

## 2.1. Legal/Institutional Issues

*The Constitution of the Republic of Bulgaria* (the State Gazette, No. 56 of June 13, 1991) establishes the foundation for the development of local self-government. The municipality is considered a core element of the local administration within the legal framework of the Constitution.

The major legal document with respect to local government and municipal administration is *the Local Self-Government and Local Administration Act* (LSGLAA, published in the State Gazette, No. 77 of September 17, 1991). It details the issues regarding the rights and responsibilities of the local government bodies. The basics of the municipal financial regulatory environment are introduced in compliance with the major activities of the municipality.

Article 5 of the LSGLAA states that "the Bulgarian municipality is a principal administrative and territorial unit where local self-government is exercised." The team found evidence during the on-site visits that self-government is not in fact occurring as envisioned and expressed by this Act. In fact, the team found evidence that some administrative functions have been shifted from the local government to the central government.

*The Local Tax and Charges Act* (the State Gazette, No. 104 of December 28, 1951) is the single most important piece of legislation covering the taxes and charges collected locally. Two types of taxes are considered to be local: the building tax and the inheritance tax. The building tax is also imposed on lots and yards and is referred to elsewhere in this report as the "property tax." The local charges imposed, as of the last amendment of the Act (in July 1993), are collected for:

- property acquisition, either as a donation or against payment
- technical services
- the right to use a vehicle
- use of quarry materials
- use of markets and market-places
- use of water and sewage systems and solid waste disposal
- use of resorts, kindergartens, homes, boarding houses, and other

- veterinary services
- certification and other services of an administrative nature
- leisure and recreation centers of state and local significance

The rates of the charges are determined by *the Council of Ministers Decree No. 69* (the State Gazette No. 45 of June 13, 1975). The latest update of the Decree was on July 5, 1994. Apart from the charge for acquisition of property (donated or purchased) where the rate increases progressively, all other charges are established on a simple pro rata basis. Municipalities have been given upper and lower limits with respect to some of the charges, and the municipal council can determine the appropriate rates within the given range. The most current, as of July 1994, can be found in Appendix K.

The greater part of the municipal revenues arise from tax sharing between the state and the local budgets. The State Budget Act for each particular year establishes this relationship. The most important source of revenue for the municipality is **income tax**. Income tax is paid by individuals earning income either employed by companies or self-employed. Employees of companies have income tax withheld each time they get paid. Self-employed individuals file annual income tax returns and submit appropriate payments. Both classes of income earners file a year-end tax return form. The Ministry of Finance regional tax office monitors and collects income tax payments. It also transfers to the appropriate municipal account each municipality's share of the income tax. Half of the revenues from this tax are currently transferred to the local budget account. For the municipalities the team examined, over the last three years income tax comprised 20 to 50 percent of total revenues. The latest scales for both types of income tax enacted since May 6, 1994 are shown in Appendix B.

The second most important contribution to the municipal budget source is **profit tax**. *Decree No. 56 on Economic Activities* (the State Gazette No. 4 of January 13, 1989), and the rules for its implementation elaborate on the scheme for calculating and adjusting profits for taxable purposes, the profit tax levels for different types of companies, as well as the method by which the tax is computed and paid.

The third category of the municipal budget revenues is direct transfers from the state budget. The subsidies for all 255 municipalities are approved by the National Assembly. *The 1994 State Budget Act* specifies the methodology for determination of the subsidy amount. This methodology is explained in detail in Appendix C.

Control over the municipal financial system is exercised by both the local government and the state. Because of the close relationship between the state and the local budget, the Ministry of Finance (which is entitled to compile and implement the state budget after its approval by Parliament) is the main central government body coordinating the local finances in compliance with the overall state financial system.

The Ministry of Finance is entitled by *the Tax Administration Act* (the State Gazette No. 59 of July 9, 1993) to collect taxes, fees, and other state claims. In performance of its duties, the local tax office of the Ministry of Finance works together with the municipality financial officers with respect to forecasting and collection of the local taxes, fees, and charges and their transfer to the state and the municipal budgets.

More than half of the of the municipal revenues are spent on wages for services provided locally. The people paid out of the municipal budget, such as doctors, teachers, city administrators, etc., bear the status of government employees, and control is exercised over their wages and social security contributions. *Decree No. 30 of the Council of Ministers* (the State Gazette No. 16 of February 22, 1994) regulates the average salary of the persons paid by budget organizations. It sets the average salary amount for the local government employees for the first quarter of 1994 and the maximum salaries of different personnel categories in respect to the minimum wage of a Bulgarian employee. Salary negotiations for employees of the hospitals and the schools involve union representatives and officials from appropriate ministries. Municipal officials are not involved in the salary negotiation process. Similarly, most of the local government expenses are regulated at the state level.

In the course of the municipal budget preparation and approval, the State Expenditures Department of the Ministry of Finance issues advisory documents to municipalities with respect to their expenses. The branch

ministries work closely with the municipality in establishing service standards in their area of expertise in order to facilitate the service activities of the municipality.

## 2.2. The Budget Process

The budget process as prescribed by the MOF is as follows:

1) **Instructions.** In late July the MOF sends instructions to the local governments that give detailed explanations for the approach to calculating the expenses for each item of the budget. The instructions establish the:

- a) Number of people that must be on the payroll;
- b) Manner in which the salaries are to be calculated;
- c) Rate of inflation;
- d) Exchange rate to be used for imported goods;
- e) Extent and nature of travel by local officials;
- f) Methods for determining the maintenance and repair expenses for municipal assets;
- g) Priorities to be pursued for the capital investment budget and the operating budget.

2) **Expenditures.** The budgeting department of the municipality prepares the budget in compliance with the MOF instructions and in consultation with each municipal department and the corresponding branch ministry that has considerable influence over the final recommendations. Again, however, the municipality has little say over the spending plan.

3) **Revenues.** Information on all taxes, fees, and charges is estimated by the MOF regional tax office. Access by the municipality to the information that would enable it to prepare its own forecast of revenues is practically impossible; thus, while municipalities can challenge the estimates of the regional tax office, they typically accept them.

4) **Capital Budget.** The municipalities prepare a separate capital investment program. The program must reflect the priorities of the central government, which currently include: water supply, health care,



education, and environment and ecology. Only the projects in the priority fields have a chance for funding. The budget proposal also includes estimated costs for the projects funded with the local allocation and the requested state subsidy. Typically the state funds less than one third of the requirement. More details on the capital investment program and process are provided in a later section of this report.

**5) State Subsidy.** The total amount to be distributed to the municipalities through transfers from the state budget is determined by the National Assembly and currently amounts to approximately 3.8% of the gross domestic product (GDP). The amount to be distributed to each particular municipality is established through a formula prepared by the Local Budgets Department of the MOF. The computation formula is contained in Appendix C.

**6) Budget Approvals.** The MOF Budget Department receives all proposed municipal budgets, prepares a proposed consolidated budget for the Republic of Bulgaria, and presents it to the Budget Committee of Parliament. After approval by Parliament it becomes law. After the approval of the state subsidies by Parliament, the MOF Budget Department notifies the municipalities of the subsidy for both operating and capital budgets. The municipal council has to approve the final budget within one month and submit it to the MOF. If the municipal budget is not approved and submitted on time, the MOF can suspend subsidy transfers.

The municipal budgets the team examined do not fit any Western European or U.S. standard of format or process. The budget process is used principally as a negotiating tool between the local governments and the central government to determine the amount of subsidy for the municipalities. Budgets are prepared manually with a format established by the Ministry of Finance. Accounts are uniformly coded, and precise requirements are set forth for completing and reporting on the budget process. The budgeting methods used to allocate governmental revenue and expenditures are determined by MOF, which also sets specific standards and targets for all expenditure and revenue categories.

The State Budget Act requires that the central government provide at least 90% of the determined subsidy, but the same Act states that the

subsidy is provided within the limits of the actual collections of the state. Other expenditures have higher priority on the state list than the local budgets, and for this reason the municipalities in many cases do not receive the subsidy they are entitled to. The review of 1993 financial statements in the three municipalities reveals an average subsidy receipt in the range of 75 to 90%.

### 2.3. The Accounting System

*The Accountancy Act* (the State Gazette No. 4 of January 15, 1991), *the National Chart of Accounts* (the State Gazette No. 26 of April 2, 1991), and *the National Accounting Standards* (the State Gazette of January 15, 1993) constitute the basis of the accountancy practices in Bulgaria. Bulgarian municipal accounting systems operate under the regulations and controls set by this legislation.

One of the problems identified in the accounting system is that the current accounting method prescribed is based on recording cash transactions only. As such, it often does not reflect current financial or economic activity and thus does not provide accurate or timely information about a municipality's fiscal condition. For example, local governments will often delay payment of accrued liabilities when no cash is available. This has resulted in unfunded deficits being "rolled over" from one period to the next. Revenues are recorded when funds appear on a municipality's bank account. Deposits are made to the municipal bank account by the regional tax collection office and are based on the pre-determined revenue sharing formula. Some revenues, such as fees and fines, are transferred to the municipal accounts weekly. The municipality waits for the bank statement to acquire information for the accounting system. Cash accounting, therefore, does not reflect the revenues that have accrued to the municipality as taxes and other fees and charges become payable according to law. Municipalities, therefore, cannot account for receivables and uncollectible revenues.

Municipalities account for expenses when the forms used to transfer funds to the vendors who provide goods and services are processed. Often when funds are unavailable, the municipalities simply do not process the form for payment. At the end of the fiscal year, unprocessed expense forms are

reported to the MOF and are paid from the next fiscal year's funds. When budgeting for the next fiscal year, however, no allowances are made for past payables. This results in the "rolling over" of deficits and accrued liabilities and can have a catastrophic effect on the municipalities' finances. This annual "rolling forward" of unfunded payables and other liabilities is metaphorically like a tidal wave rolling toward the beach which will add substantially to inflation, an already unstable currency, and the inability to achieve creditworthiness within any forum for long-term credit markets. These fiscal deficiencies for Rousse and Blagoevgrad for 1991, 1992, and 1993 are shown in Appendix H.

### 3. CURRENT REVENUES AND EXPENDITURES

#### 3.1. Principal Revenues

Local governments rely on four categories of revenues: taxes, charges, other revenues, and relations and financing. The last category, "relations and financing," represents transfers from the central government to the local governments, often referred to as a "subsidy." For 1993, total revenues in the studied municipalities were comprised as follows: taxes 61.11%; charges 7.39%; other revenues 5.97%; and transfers 25.53%. See Appendix F for a cumulative summary of revenues for the three municipalities for 1991, 1992, and 1993; and Appendix O for a graphical presentation of major revenue sources.

The following is a description of the principal local revenue sources:

1) **Income Tax.** The tax on personal income is the largest source of municipal revenue. Legislative changes have adversely affected the local allocation. Initially, the tax revenue was entirely assigned to municipalities. In 1992 the allocation became 30% for the central government and 70% for the municipalities; since 1993 the allocation has been 50% for the central government and 50% for the local governments.

2) **Turnover Tax.** This tax was being paid by businesses on the sale of goods in compliance with *the Turnover Tax Act*. Revenue from this tax collected within a municipality from private and municipally owned

businesses was returned to the municipality. This source provided a substantial portion of local revenues (approximately 15%). However, on April 1, 1994, the value added tax (VAT) was enacted and replaced the turnover tax. The proceeds from the VAT go directly to the central government. The 1994 State Budget Act provides for the possibility of some additional transfers to the municipalities if the VAT State Budget Account shows a surplus at the end of the year.

**3) Real Estate and Property Tax.** This tax produces insignificant revenue and is based on a valuation method primarily focused on gross area without consideration of market value. However, there is an indication that the assessing unit of the regional tax office has not been including all new additions to property in the valuation base. Including such additions could produce additional revenue. Also, there is a bill in Parliament, supported by the MOF, which would modify the valuation method to incorporate market based factors and would give the municipalities authority to adjust the tax rate. A draft of this Local Property Tax and Rates Bill is included in Appendix L.

**4) Excise Tax.** This revenue comes from the excise paid by private individuals on spirits and wine production for their own consumption. The importance of this source is negligible.

**5) Profit Tax.** The profit tax is regulated by Decree No. 56 of Economic Activity. All companies with more than one million BGL profit pay a 40% tax on their profits. The tax coming from municipally owned and small private companies is transferred to the municipal revenue account. The state owned and the municipally owned companies pay an additional 10% tax on their profit to the municipality. Because of the poor state of the economy, the profit tax transferred to the municipality does not account for more than 10% of total municipal revenues. There is strong concern among some government officials that many private companies are understating profits and/or are not paying the appropriate amount of tax.

**6) Municipal Property Rent.** While not a substantial portion of local revenues currently, municipal property rent is a source controlled by the municipality in terms of the payment level and indexing to inflation during

the period of the lease. This field of municipal activity has a high potential for revenue enhancement once an appropriate and efficient system for claiming, maintaining, tendering, and control of municipal property is in place.

**7) Technical and Administrative Services.** The municipal administration provides several different types of services with respect to: approval of construction, issuing drawings for construction sites, legalizing properties that have been built without proper permits, etc. The collections made for these services account for about 25% of total municipal charges. The rates of these charges are determined on a simple pro rata basis by the MOF. In most cases the rates are updated annually and do not reflect in full the cost of the provided services. This is even more so with the high and unpredictable current fluctuations of the rate of inflation.

**8) Use of Vehicles.** The local charge is imposed on all motor vehicles. It is collected annually, and the rates are set by the Council of Ministers. The rates depend on the volume of the engine, the number of seats, and the tonnage of the vehicle. This charge represents about 1% of the total municipal revenues; it is very dependable and relatively well established in terms of monitoring and collection. The charge is also expected to show a trend of growth with the fast increase of the number of vehicles throughout the country.

**9) Interest-free Loans.** The Bulgarian government extended interest-free loans to most of the municipalities in 1992. Because of the inability to pay, the 1994 State Budget Act has rescheduled these loans for payment by the end of 1995. Practice proved the high level of subjectivity in extending this type of loan, and the central government is very reluctant to continue providing this type of support to the municipalities.

**10) Subsidies.** The subsidies are the main means for transfer of funds from the state to the municipalities. The total amount of a subsidy takes into consideration the overall revenue-expenditure requirements of the municipalities, the prescribed requirement of the international financial institutions supporting the Bulgarian financial system transition, and the ability of the state budget. As already discussed, a formula for

distribution of the subsidy to all 255 municipalities has been established to consider both the historical structure of the subsidies distribution, as well as a set of objective criteria. The weight of the historical structure is diminishing starting from 1992 with 100%, through 85% in 1994, and is expected to reach 50–65% in 1995, in order to ensure smooth transition giving way to 100% objective criteria determination in the near future.

The above represent the main municipal revenue sources. Again, it is emphasized that the central government establishes the rate or the range of the rate for all taxes, fees, and charges. It is expected that pending legislation in Parliament and described earlier, would give increased authority to municipalities to set the rates.

The collection of all taxes, fees, and charges is exclusively under the control of the MOF and its regional tax offices. There are currently 28 tax collection offices. Municipalities are not allowed to have a collection process. This is an area of "recentralization." Before the reform, municipalities could and did collect some of the local revenues. There is considerable concern among the officials that improvements to the enforcement and compliance area are necessary. For instance, if a person under-reports income for a specific activity and is caught, in most cases, the only payment required is the tax liability at the regular rate plus the market rate of interest.

The municipalities own a substantial number of businesses which, if privatized, could provide a source of capital for other capital investments. Privatization has been slow, however, the recent changes of *the Transformation and Privatization of State and Municipal Enterprises Act* (the State Gazette No. 38/1992) (New Law? (July, 1994 (VERIFY) create serious incentives for the municipalities to view the sale of Municipal companies and assets as an attractive option in raising additional revenues.

### 3.2. Principal Expenditures

The principal expenditure categories as prescribed by national law include:

- 1) Science and Education
- 2) Culture and Arts
- 3) Health Care
- 4) Construction and Development
- 5) Social Support
- 6) Tourism and Sports
- 7) Land Division and Marking
- 8) Youth Activities

Appendix G illustrates the cumulative expenditure budgets for the three cities. Education and Health Care comprise approximately 70% of the entire budget; therefore, the team concentrated its efforts in those two areas.

As has been stated before, the municipalities have virtually no authority or flexibility to develop a spending plan based on local needs. The respective ministries set the standards and norms based on demographic factors not always reflective of local conditions and needs.

Financial analysts and program managers in the municipal governments are called upon to give expert opinions about the appropriate levels of salaries and other expenses to request in the annual budget presented to the Ministry of Finance. While some amount of negotiation takes place between the MOF and the municipality, the imposition of norms prescribed by the various national ministries will predominate over local need in most cases. This means that there may be over-appropriations in some budget areas and under-appropriations in other areas if one defines needs using subjective, locally-derived criteria.

The use of objective, standardized, inflexible nationwide criteria for setting appropriation levels leads to inequities and shortages. The resulting curtailment of services causes crises at certain times of the year in certain locales; failure to remove snow and ice due to lack of funds is one example.

It must be mentioned, however, that municipal officials have been creative and ingenious in mitigating this set of restrictions on their ability to budget effectively. Much "off the books" activity takes place in some municipalities, invoices are delayed or not paid in some cases for

municipal services, and statistics are used to the advantage of the municipality whenever possible. Sometimes with the tacit cooperation of ministry officials, ways are found to accommodate a very serious shortfall in funds and the inability to reduce municipal expenditures prescribed from above or to find new sources of revenues in the absence of enabling legislation.

The effect of this adaptation is almost all negative, however. Aside from promoting a distrust of government in general, such practices tend to alienate vendors and potential bidders for municipal contracts, to inflate prices municipalities must pay (informal insurance against default), and to weaken the case for more central government subsidy of local government.

The overall effect of this blurring of municipal service needs, and the lack of accurate or complete statistics on populations served or supplies and equipment used, is to prevent the clear identification of service costs and the setting of fees for those services on some objective criterion, such as the approximate cost of providing the service.

In that the relationship of municipal fees for services to the cost of producing the service has not been documented, this report proposes that cost of service analyses be conducted which would form the basis for the establishment of appropriate fees derived from local costs. The need for this cost/fee relationship to be defined and measured is discussed later in the report.

Another method by which municipalities can recover the cost of services they provide is to find a way for municipal hospitals to receive payment for treating patients from other jurisdictions. Currently, municipal hospitals serving citizens who pay taxes in other jurisdictions cannot collect fees from those jurisdictions. This is especially costly in those municipalities with high itinerant populations. The MOF is aware of and sensitive to this problem. The solution may ultimately rest with the regional administrative offices, wherein revenues would be collected regionally and related to the specific service activity that "cuts across" several municipal boundaries.



The accounting for and treatment of municipal funds are prescribed by national law; therefore the charts of accounts, reporting mechanisms, budget cycles, etc. were the same in all municipalities studied. There was some variation in the internal reporting of expenditures, which monthly updates the norm in the collection of spending data. In most municipalities the reporting system is manual, with many cost centers reporting to the office of the Chief Accountant. Such a system has inherent inefficiencies, yet there did not seem to be a widespread problem with identifying of accounts in danger of being overspent.

Funds from under-expended accounts may be carried over into the next fiscal year, but must be distributed among all budgetary accounts rather than channeled to activity accounts that are considered to be local priorities. This is a disincentive to reduce expenditures through increases in productivity and direct reductions in cost.

Special fund accounts, referred to as "off-budget," are allowed, but most of them are established or approved by the Council of Ministers or the MOF. Operating surpluses may not be transferred into them to build up fund balances or capital reserves. Some of these accounts must be expended in the current year, or the fund balances must be returned to the particular account of the central government. Local officials need more control over the off-budget accounts, especially when they are established for infrastructure purposes.

As with the situation for revenues, the high and variable inflation rate made a trend analysis of expenditures difficult. While budget requests are adjusted for inflation, the process of doing so is not well understood outside the central budgeting office of the municipality, and the need for long-term revenue and expenditure forecasting is not considered valuable or necessary in this environment of shrinking revenue sources and increasing administrative responsibilities for municipalities.

#### **4. RECOMMENDATIONS FOR SHORT-TERM IMPROVEMENTS**

This chapter provides recommendations for revenue enhancements, expenditure reductions, and/or cost avoidance that can be accomplished without any change in existing legal/institutional requirements imposed

by the central government. Moreover, these improvements are not uniquely beneficial to the city specified, but can be disseminated to any municipality in Bulgaria.

#### **4.1. Revenues**

Revenue administration for local governments in Bulgaria faces two types of impediments -- legal and administrative. Legal limitations are imposed by national law and are do not provide for direct taxation by local governments in Bulgaria. Rather, the legislative body of the central government taxes citizens for both national and local taxes. The Ministry of Finance and the Council of Ministers govern the execution of the laws and provide certain functions of revenue administration to the local governments. Recent issuance of a decree by the Council of Ministers regarding certain local government charges, and interviews with pertinent officials of the executive branch of the central government, indicate that there are plans to liberalize certain revenues for local governments and assign revenue raising powers to localities.

Administrative limitations exist at the local level because of misapplication of personnel resources and the employment of manual, antiquated systems for record keeping and registering activities and assets. The short-term improvements this report recommends address administrative issues only. Improvements suggested can be implemented, with technical assistance, under current regulations and resource restrictions. Long-term improvements, addressed later in this report, deal with issues that would require changes in existing law and may be effected later in the development process of local government control over financial functions.

For the short-term revenue administration improvements, the team examined all sources of income for Bulgarian municipalities listed in the uniform budget employed by all municipalities in Bulgaria (budget item codes 1-61). To arrive at the recommendations for short-term improvements, the team examined the legal and administrative structure of revenue management as it exists currently and identified areas where revenue enhancement is possible without requiring legal or legislative changes.

The Ministry of Finance recently issued a decree allowing municipalities to set a number of charges and fees related to municipal services, within certain ranges. Currently, municipalities do not have capacity for calculating proper charges for various categories. Training on rate setting mechanisms and techniques for monitoring and enforcing compliance will assist municipalities to demonstrate that they are capable of establishing their own fees and administer collection procedures.

This report focuses on projects for short-term revenue enhancement that are within the existing legal parameters, are likely to generate additional revenue quickly and effectively, and are feasible and desirable to each municipality.

### Rousse

**a. Conduct a cost of service study for municipal services related to management of building permits and tendering process with respect to development of municipal property.** Assist the municipality with calculating the cost of inspections, registration, and monitoring of the building process to establish appropriate charges. This is expected to raise revenues immediately, since construction activity is increasing. Currently, the municipality does not calculate, monitor, or enforce collection of fees associated with building management.

**b. Update property tax rolls.** This will include computerization of property tax records, training of assessors to inspect property characteristics, and classifications under existing property tax law. Create records of municipal property and privately owned property in the jurisdiction to assist with property tax collections and management of rents. This will increase revenues immediately, since many properties are not currently on the property tax rolls, or are recorded with outdated characteristics.

**c. Create a financing mechanism for capital improvements of municipal property.** Make the financing mechanism self-supported rather than tax-supported (revenue bond financing). Examine pledging a

portion of rental income or another dedicated revenue source to service debt for acquisition of capital to fix existing properties in need of repairs.

Of particular interest is the financing of repairs of the downtown performing arts building. This historic building is located on the main square of Rousse and is currently unusable. It is possible to establish a mechanism under which financing for necessary repairs can be obtained by either a bond issue or a direct loan to repair the facility and put it to use. The facility will generate revenues once put to use, and a large portion of these revenues can be pledged to service the debt. It will be necessary to pledge another source of revenues to provide adequate debt service coverage. In this case, the municipality can institute an additional charge on the rents it charges for use of municipal property. This pledge of a portion of the rental income will cover debt requirements and will result in instituting the concept of revenue association with specific government outlays. In addition, it can be shown that the businesses and individuals contributing to the improvements of the performing arts building will derive direct benefits by having it in operation.

### **Bourgas**

**a. Institute real estate property computerization.** For this project, it will be necessary to improve and update real estate property information through entry of existing property records into a database and verification of existing information through inspections. Finally, the project will compare information with the database available at the MOF regional tax office and make updates, as necessary.

**b. Create a municipal department for registering and monitoring commercial activity of small businesses and ensuring payment of fees and taxes.** Currently, local tax authorities are responsible for assessing and collecting fees and taxes from all businesses. Since the fees and taxes from local businesses all go to the municipality, typically are not large amounts per business, and regional authorities do not possess the necessary information or enough resources, local tax people do not focus their efforts on this revenue category. Regional tax authorities usually spend most of their time monitoring and

collecting taxes from large industrial and commercial enterprises. Interviews with pertinent officials from municipal administration and regional tax authorities revealed that estimates for uncollected taxes and fees from local businesses reach 90 percent.

The municipality possesses the registration records for local businesses and can create a database of such enterprises, calculate pertinent fees and taxes, and assign personnel to work with regional tax authorities to enforce collection of appropriate fees and taxes. This area of commercial activity is expected to grow rapidly in the near future. The proposed program, in addition to providing additional revenues to municipalities, will assist local businesses with understanding tax compliance and fairness issues.

c. **Perform a technical and economic study and analysis of the water purification plant development for the "Meden Rudnik" housing estate.** The Meden Rudnik housing estate in Bourgas is a section of the city with approximately 70,000 inhabitants. It is the only section of the municipality that does not have wastewater treatment facilities. All wastewater transmitted to the Black Sea is untreated. The municipality has explored wastewater treatment options for this section of the city and has selected the most appropriate method for this situation. The municipality has also examined the legal and regulatory issues related to this project and has determined that the project is feasible under existing laws and regulations. The municipality has prepared preliminary engineering studies and has concluded that the project would require approximately four million U.S. dollars for completion. The team recognizes the importance of this project to the municipality and proposes a feasibility and rate study and formulation of a proposal for financing the project. The team recommends assistance that will create a method for setting rates and hook up charges for users of the system and will establish credit criteria for financing the project. Emphasis will be placed on achieving self-reliance for the project for both operating and capital amortization requirements. Consideration will be given to acquiring donor agency funds for leveraging project's revenue stream. If such funds are necessary for the completion of the project, technical assistance will include recommendations and preparation for the donor agency funding request.

d. **Provide technical assistance for improving the municipal information system (IS) and its capacity.** Conduct research to establish the IS function in municipal administration. Create system requirements in specific areas (finance, procurement, asset management, etc.). Provide support for the acquisition process of IS requirements. Create technical courses for municipal employees in IS usage and administration.

### **Blagoevgrad**

a. **Assist the municipality with accounting and management of its assets.** Focus on creating a balance sheet that reflects the municipality's fiscal position and on accurate accounting of municipal property, including municipal corporations. Currently, the municipality is the sole owner of 12 municipal corporations. The value of each corporation has not been established; as a result the municipality does not carry the proper asset values on its balance sheet. Balance sheet data are important when evaluating a municipality's creditworthiness and borrowing capacity. This proposed program will assist the municipality with accounting for all property it owns and provide for methods to evaluate strategic planning for asset divestment. It will also increase the municipality's ability to raise funds for capital projects by pledging certain assets as collateral.

This program will develop a consistent methodology and reliable systems for asset management. There exist sporadic examples of computerized asset management systems, especially in the area of municipally owned property that is rented out. Technical assistance should focus on helping the municipality create a fixed asset system that can be tied to its general ledger accounts for better tracking of purchases, disposal, management, and losses of fixed assets and inventories. Fixed asset management should include accounting for initial cost, length of service, salvage value, and unpredictable losses of governmental fixed assets. A review of existing practices revealed that no such accounting exists today. The information may exist in some form, but it is not updated to reflect changes in a local government's fixed asset composition.

b. **Computerize personal income tax records for individuals and sole-proprietor businesses.** Currently, the municipality maintains manual records of these two categories of taxpayers. This makes monitoring of tax records difficult and comparisons with collections with records from the MOF regional tax office cumbersome and unreliable. The proposed program would make records available to the regional tax office on a timely basis and would allow for cross-checking declared income information against business activity registrations.

#### 4.2. Expenditures

##### Burgas

1. **Develop management techniques for "current" repairs to educational facilities.** Education administrators stress the problem of school maintenance for their 100 buildings. Chronic under-funding of "current" repairs (repair jobs costing less than 100,000 leva) has created a situation where the municipality's property managers cannot keep pace with deteriorating building systems and components or the damage caused by vandals. While there are private firms willing to bid on school repair jobs, the municipality has found that those firms have only recently been formed, and as such, few have any record of achievement in the repair business.

School building managers have few staff to deal with the problem of building deterioration, and they lack confidence in their own ability to award contracts to the most qualified firms in terms of relevant background and the skills of the firms' workers and tradespeople. While the general tendering process is well-established in Bulgaria, and the mechanical aspects of solicitation and bid evaluation are generally in place, Burgas officials feel that their limited repair funds could be used to more effect if programs were implemented in the following areas:

a. **Train officials in methods for analyzing the qualifications and backgrounds of bidders.** These would involve, among other measures, a demonstration on the part of bidders that they are qualified as a firm by prior experience, or as individuals by trade or skill credentials. Bid documents would be modified to take into account

equivalent experience to the type of work being bid, and would be designed to permit valid comparisons by skill category of workers, numbers and types of complaints from previous contract administrators, and a verification method as to the firms' histories, perhaps through tax records and purchase orders for the prior jobs cited in the qualifications documents.

**b. Create a greater management capacity for monitoring the quality of repairs.** With only five staff dedicated full-time or part-time to the repair and upkeep of about 100 structures, the municipality has a problem not only in supervising contractors, but in planning how to allot repair jobs among critical areas of need. There are serious problems in plumbing, wiring, roofs, and windows that require immediate attention just to keep certain buildings habitable.

Routines should be established for rank-ordering and scheduling the most critical repair needs of buildings and providing appropriate training to the municipal personnel assigned to the supervision of repairs. That is, basic training of repair supervisors in the particular trades they are most likely to supervise, as well as in the rudiments of construction scheduling, materials selection, and cost accounting from a contractor's perspective would enable the municipality to direct its repair efforts and to create a better working relationship between the repair supervisors and the firms they will supervise. In addition, such a heightening of municipal capacity will encourage bidding beyond the current average level of 15 bidders per job.

**c. Develop a preventive maintenance program (methods and materials).** The problem of aging structures that are not capable of being repaired adequately with existing budget allocations (six million levs in 1994) is exacerbated by a high level of vandalism. This increases the need to use durable materials and other measures which will free up scarce funds for repairing the buildings' critical systems (plumbing, wiring, etc.). Increasing the life expectancy of windows and other components is essential to turning the tide on vandalism and in the long run increasing public respect for the buildings. A standard approach to preventive maintenance should be incorporated into an overall repair program for



school staff, including a detailed examination of durable materials and equipment to replace those that are damaged by wear and by vandalism.

**2. Develop software to computerize medical records.** The greatest expressed administrative control problem in the Health Department of the municipality is the lack of comprehensive records on patient care costs, facilities usage, and the prescription of medicines. While handwritten records are kept for each inpatient, there is no centralized database, either computerized or manual. Such a database is needed for measuring various unit costs and for gauging the overall effectiveness of the staff.

In terms of costing of services, the greatest need is for comprehensive, computerized information on cost by type of illness, by length of stay, and by treatment(s) administered. From these data a cost per bed figure can be obtained for budgeting and planning purposes. These data will lead to policies which will monitor and control certain costs of operation, and will over time provide a basis for replacing the current system of ministry-imposed norms for assigning numbers of beds and physicians to regional hospitals. Such norms are currently based on demographic criteria, such as the overall permanent population of the region served, rather than the need of the region for medical services.

Just as importantly, having a computerized database that includes complete histories of each patient stay will lead to the creation of measures of effectiveness of individual physicians and types of treatment administered. For example, a well-designed database and software will provide regression analyses for quality of care which would be based upon such measures as:

1. frequency of complications after treatment
2. the coincidence of the diagnosis by the admitting physician and the attending physician, by patient
3. in cases of death, the coincidence of the diagnosis by the attending physician and the autopsy results.

The Ministry of Health (MOH) has begun to install medical software in some jurisdictions and in some areas of record keeping, but not yet in

Bourgas. There will be a need, therefore, to single out those areas of database creation and management that will augment or supplement the MOH's applications, and also conform to existing MOH reporting formats. If such software is developed and implemented, then the effort now carried out by 25 clerks at year's end to create and submit summary reports to the MOH will be greatly reduced. Future staffing needs will be reduced as a result of such automation.

### **Blagoevgrad**

a. **Develop Health Department software and applications.** The regional hospital in Blagoevgrad serves the municipality and an outlying area, with a combined population of about 300,000. While the number of beds in the hospital is pegged at 764, the actual number funded and in use is 300. In order to control what is perceived as a crisis in regional health care, hospital administrators have adopted an aggressive policy of reducing the average stay for patients. In 1993 that average was 9.7 days. This year to date it is 8.5. In order to reduce this number further, administrators need to assemble and organize information about types and frequencies of illness, and to develop treatment policies which most efficiently use bed space, thereby containing costs. For example, the Deputy Medical Director cites the goal of establishing procedures for one day treatment of certain medical problems. This will consist of minor surgery, performed in the morning with the recovered patient leaving in the afternoon. Thus hospital staff and facilities will be tied up only minimally.

In order to establish this type of "same-day" treatment, certain policies will need to be developed which provide for best practice surgical techniques and follow-up procedures. There is no effective way to track and control this volume of minor surgery and follow-up care with a manual system. As noted above, the Ministry of Health has produced and applied software in some municipalities, namely for record keeping in polyclinics, for managing partially and totally disabled outpatients, and for tracking medication.

Software designed and tested in Blagoevgrad could be applied to other regional hospitals in Bulgaria. Most important among these applications

aimed at cost containment would be: limiting length of stay; maintaining training and other personnel records; monitoring and controlling medication; and analyzing total cost based on per bed cost, per stay cost, and cost by type of treatment. Eventually, highly quantifiable units of service derived from these software applications will provide the basis for abolishing the MOH norms currently in effect, and regional hospitals, all with different caseloads and demands for various kinds of treatment, will enjoy budgets more reflective of their true needs for space, equipment, and staff.

**b. Analyze building systems and structural problems caused by defective materials and workmanship: Education Department and Invest Engineering Company/asset management.** As in Bourgas and other cities, the age and quality of school buildings in Blagoevgrad are causing maintenance problems beyond the financial ability of the municipalities to deal with effectively. Many of the structures are of the penalized type, with defects in roofs, plumbing and wiring, sewer connections, windows, and panel joints causing severe problems. Many defects in workmanship and materials are appearing even before the end of the warranty period for the buildings (often seven years), and even then the municipality has difficulty in collecting damages from contractors and materials suppliers.

The Invest Engineering Company, a municipal enterprise, is responsible for contracting school building construction, for monitoring building construction, and for seeking compensation from contractors who have erected buildings of substandard workmanship or with poor materials. Invest Engineering officials report that poor quality materials no longer are permitted in school construction, but that construction skills of contractors are sometimes inadequate, and poor workmanship often slips through the understaffed inspection workforce. Moreover, construction contracts have not been written tightly enough to favor the municipality (the "owner") in disputes with contractors.

Several major initiatives need to be taken in this area to bring about maximum cost avoidance in the future. First a detailed program should be established for identifying defects in existing school buildings and setting a schedule for repairs and for recovering funds where possible

from the contractors and suppliers for each building in question. While it is unlikely that a great deal will be recovered for defects in buildings more than a few years old, it will be useful to ascertain which firms have presented problems in the past, in order to screen them out of bidding on future projects. Also, the identification and costing of repairs for defects will enable the Invest Engineering staff to incorporate such estimates in a unified capital improvements program for all municipal buildings, a program of considerable merit for the next several years.

A construction scheduling program for the buildings which are now under construction is clearly needed, in conjunction with a plan to complete the construction of some of the buildings and to abandon other partially-completed structures. Under the previous regime as many as ten school buildings were begun in one year. With diminishing capital funds available, the practice arose of apportioning some funds to all the buildings each year and to proceed with construction as long as funds lasted.

A capital improvement plan (CIP) could readily be developed based upon well-defined assumptions about the availability of national funding and local resources. This program would enable the municipality to complete the most urgently needed school facilities on a timely basis.

A preventive maintenance program for the new buildings should be coupled with the CIP. This would be based upon the use of the best available materials, through redesign of buildings where still feasible, avoiding the use of any materials and building techniques which were problematic in the past. For example, specifying new roofing techniques and window systems would appreciably lessen future maintenance. Adding ventilation systems would not only provide a healthier environment for students and teachers, but would reduce moisture problems as well.

Technical assistance should include the development of contract language to protect the owner against contractor defaults and to ensure better contractor performance in constructing municipal facilities, including the requirement that tradespeople be licensed.

Municipal officials report that there are no legal impediments to devising and enforcing contracts which clearly set out rigid standards for builder warranties for workmanship and materials, and which specify penalties

for non-timely performance. Also, there is a need to protect the municipality from liquidated damages for hidden defects which appear after building occupancy. Training of municipal staff in all such contract matters, with model contract language and procedures, would aid greatly in establishing a better regulatory function for municipal oversight of construction. In addition, municipal staff members should be given training in building systems and construction management to ensure proper testing of materials and building systems, conformance to plans, and daily contractor performance.

Blagoevgrad's building officials are actively working toward the requirement that all tradespeople working on municipal building projects be licensed in their respective trades. Such a requirement would eventually be made a part of all contract specifications, so that bidders would enlist the services of only those tradespeople who have demonstrated their qualifications. Instituting such a program will be a lengthy process, and while perhaps beyond the scope of this project, advice should be given to municipal officials pioneering in this area of building construction quality control.

## **5. RECOMMENDATIONS FOR LONG-TERM IMPROVEMENTS**

This chapter will recommend long-term improvements applicable to any municipality in Bulgaria. However, for optimum long-term benefit, changes in legal/institutional requirements imposed by the central government may be necessary.

### **5.1. Accounting System**

A parallel system of accounting that employs accrual accounting methods will allow the municipality to make management decisions based on figures representing economic activity, rather than cash transactions. It will provide for monitoring of uncollected revenues and accounting of accrued expenses that currently pose an unfunded deficit problem. This part of the technical assistance program should focus on providing local governments with an understanding of system design and creation of software specifications for accounting applications that take into account

principles of accrual accounting. The program should create fund structures that take into account the different activities in which a local government is involved. Specifically, the program needs to address the concept of the general fund accounts, which are used for paying for general government services and are funded mainly by taxes, and enterprise fund accounts that serve specific functions and are funded by dedicated, separate revenue sources.

Currently, the software used by all Bulgarian municipalities the team examined is designed by MOF. It is a dBase application that relies on a pre-set database structure to record cash activity after the related forms have been processed. The technical assistance program should focus on providing finance officers of local governments with an understanding of the benefits of having a software program that records accounting entries that reflect actual economic activity.

To evaluate the benefits of automating the accounting and budgeting processes, the technical assistance program should develop a series of questions to investigate in detail the following areas in which a computer-based accounting system can provide efficiencies:

- Improved information and accountability
- Cost savings/control
- Plans for growth
- Citizen services
- Citizen participation

Next, the technical assistance program should focus on determining which application systems offer the greatest potential benefits for a government. The following are among the areas commonly automated by governments:

- Fund ledger
- Budget preparation and reporting
- Accounts payable/encumbrances
- Revenue/cash receipts
- Fixed assets
- Utility billing

- Word processing
- List management
- Electronic spreadsheet
- Graphics
- Communications

The program should also provide local finance officers with guidance to develop a list of questions to examine the government's structure and identify potential problem areas. The program should offer suggestions on how to address any common problematic areas associated with automation. The goal of this technical assistance program should be to create a system of automated accounting that local governments can use to administer their finances and demonstrate that the system currently mandated by national law does not meet their requirements for effective decision-making, management, accountability, and citizen participation.

## **5.2. Operating Budget**

It is essential to provide technical support in budget preparation to develop a format that is conducive to using the budget as a decision-making tool for local officials, a financial tool for fiscal accountability, and a communication tool for citizen understanding and support. Currently, budget documents and the budget process are designed to assist central planning for economic activity and resource allocation. Reliance on Ministry of Finance data for revenue budgeting and on national laws and standards for service levels leaves local governments with little room or incentive for preparing budgets that reflect regional differences in economic conditions, or take into account citizen preferences for public resource allocation.

The proposed technical assistance program will focus on alternative methods for preparing local government budgets. Its purpose will be to provide local government officials with a good understanding of the benefits of locally-prepared budget documents and the basic skills required for initiating a budget process that is compatible with market economies and effective local self-government.

The diagnostic analysis of existing budgeting practices of Bulgarian local governments indicates that a need exists to introduce new ways of thinking and new skills for officials responsible for preparing budgets. It was encouraging to witness in this initial evaluation a desire by local budget officers to learn more about preparing budget documents that reflect local economic and political conditions rather than centrally-planned policies. This desire for change has been heightened by recent allocation crises caused by the inability of local officials to shift appropriations within budgets, for example, from doctors' salaries (too many doctors) to medicine (barely enough funding to cover inflation).

At present the municipal budget document is set out in a line item format, with no description of the programs the municipalities are to carry out with allocated funds, no enunciation of local spending policies or goals, and no description of the various steps involved in developing a budget document which is a spending and revenue-raising plan for the public's money.

As such, the budget is a contrived document which reflects line item amounts negotiated with the MOF, and for the most part the figures are derived from arbitrary norms based on demographics rather than a perceived, quantifiable local need for services. The lack of a vibrant national economy and a balanced national budget contribute to an attitude at the local level that there will be deficits for many years, and the best way to budget is to submit requests based on the previous year's amounts and hope for the best outcome. This view unfortunately contributes to a lack of preparedness for the time when municipalities will once again have adequate revenues to execute the programs mandated to them. Unless training in budgeting techniques begins soon, there will be no cadre of municipal financial officials who can analyze programs by using realistic and meaningful output measures; nor will municipal financial officials be able to develop revenue generation programs reliable enough over time to create an atmosphere within municipal financial circles that will, among other things, promote the practice of debt financing.

It is unrealistic to assume that better budget formats will lead immediately to greater subsidies from the central government or more realistic funding for any particular line item or set of accounts. The



intent here is rather to develop a document which department heads will find useful as a planning and fiscal control tool, and to enable the public to gain a better appreciation for how its tax dollars are being spent locally. For example, descriptive materials could be produced which describe a rational school building program and how decisions are made about which schools to finish and which ones to defer. There will of course not be enough funding to complete all the buildings, but the citizens will become better informed about the need for classrooms, gymnasiums, and other critical building components if such materials are included with the budget. Through wide dissemination of budget documents, municipal officials may stimulate an interest in public affairs which will lead to more informed and coherent dialogues with citizen interest groups and individuals.

With today's desktop publishing software it is possible to expand and embellish the municipal budget into a format which is suitable as a management tool and an instrument of public participation. By using cost of service criteria, trending of expenditures and revenues using bar graphs and pie charts, narratives about service needs and delivery levels in non-technical Bulgarian, and simplified descriptions about how municipal budgets ought to be developed and administered, municipal administrators will be better able to convey to interested citizens and the media the issues facing them as they adapt to increasing program responsibilities and shrinking subsidies from the central government.

In order to increase interest on the part of citizens, the presentation of detailed, "user friendly" budget information at the mayor's periodic press conferences could be a first step in effective dissemination of budget materials. Coordination with local non-governmental organizations (NGOs) to distribute the budget more widely and to sponsor forums to discuss the annual budget's components could supplement efforts on the part of municipal officials to put the document in the hands of as many people as possible through traditional means such as posting it and putting copies in libraries and other public buildings.

In addition to the desire for change, the skills necessary for learning new methods of preparing budgets appear to be in place. What is needed is training for budget officers in new budgeting methods. In order to be more

reflective of current conditions, the operating budget process must have a consistent, specific form. This form starts with the establishment of a budget cycle, and that budget cycle concept should be the focal point of technical assistance. The components of the budget cycle will be introduced and discussed, and a form for preparing an effective budget cycle will be prepared.

The budget cycle contains four stages: preparation by appropriate authorities, typically the executive branch of government; consideration by citizens and their elected legislators; execution; and review, audit, and evaluation. In the proposed training, examples of each stage would be provided and exercises would be used to demonstrate the functionality of each stage, as well as the relationships among the stages.

In order to phase in a public awareness of spending and revenue issues, and to promote the concept of local self-government as more than just the election of a mayor and council, some of the descriptive, program-oriented elements of budgeting should be introduced. This will have a positive effect on the administrators of the budget and of municipal departments, in that each will have a stake in long-range financial planning, each will adopt a more outcome-oriented approach to expenditure allocation and revenue forecasting, and each will have a more complete understanding of all the operating units of local government.

In order to implement a program budgeting training program it will be necessary to spend time in one or more of the cities and go over the details of budget preparation as now practiced, and to identify critical budget estimation decisions and the process whereby the MOF and the municipality "negotiate" the final outcome of expenditure levels and the budget total. A program budgeting manual should also be provided. An important byproduct of analyzing the current budget preparation process would be the constructive involvement of the MOF in program delineation and design. That is, inviting the MOF to take an active role in designing a budgeting system that encourages decision-making at the local level would help greatly in discovering what proof of "financial maturity" municipalities will need to demonstrate to the MOF to obtain liberalizing laws and procedures. Delegation of MOF powers to the municipalities implies partial abandonment of arbitrary norms, development of output

measures, encouragement of new programs and general innovativeness, etc. If the MOF simply plans not to delegate such powers wholesale, the budget process exercise will probably ascertain that crucial fact.

Technical assistance should initially take the form of seminars where all top administrators within the municipal government develop and record, in systematic fashion, mission statements for their various departments, and from that begin to develop a long-term spending plan in addition to and independent of the MOF norms and regulations now in effect. Thinking through departmental goals and missions in a program-based context will translate into financial documents which, through desktop publishing techniques, can easily be drafted and disseminated for comment among elected officials and by officials of the MOF.

In addition to instilling a program budgeting orientation into local government thinking, a prime objective of a technical assistance program should be to get pertinent local government officials to focus on the methodology that needs to be employed to create reliable forecasts. Simple steps to analyze the size, timing, characteristics, and predictability of revenue and expenditure categories need to be identified. These steps will assist local government officials to attain the knowledge required to design and implement an effective and reliable revenue and expenditure forecasting and management system for local governments in Bulgaria.

The current system for estimating expenditures is best described as "modified incremental." That is, the prior year's figure is used as a base for each spending category, and after adjustment for inflation, a figure is plugged in which is dictated by the MOF's budget analysts (after some discussion with local budget estimators). While the ultimate budget figure in each category takes local conditions somewhat into account, that figure is a reflection of nationally-imposed norms or target amounts available to all municipalities, yielding 90% or less of the funds which are theoretically distributed by formula from the MOF to the municipalities.

The lack of reliable forecasts leads to a distrust of budget projections in general, and cynicism as norms are ignored and informal ways are found to deal with shortfalls. In order to prepare a more locally-oriented system of

budgeting, steps should be taken to develop a program-oriented budgeting system which uses output measures rather than arbitrary norms for arriving at expenditure projections and for predicting revenue needs. Having such practices in use in a few municipalities, even if the program-oriented budgets need to be "shadow budgets" used only unofficially as planning tools until true reform and economic recovery come about, will demonstrate that self-government will be rewarding for municipalities that can cut appropriations in areas which will need less support over time. With fiscal decentralization, municipalities can use those savings to start new programs deemed necessary by local elected officials, outside the purview of the MOF.

Specifically, the expenditure forecasting program should be based on the fundamentals of program budgeting as used in Western Europe and North America. Assistance programs should be instituted on a manageable scale, such as in local health departments, where arbitrary norms and irrelevant demographic measures have created surpluses of medical staff and beds, and expenditures are not necessarily sized to improve the quality of care or respond to emerging health needs (resurgence of tuberculosis, for example).

The curriculum used in an initial training effort could be derived from a basic program budgeting format. This would be supplemented by best Bulgarian practice, as enunciated by Bulgarian experts who would be called upon to advise program developers. A fairly small training development effort would do much to demonstrate how allocations of scarce resources can be optimized if the old central planning concepts of arbitrary norms are thrown out in favor of carefully-designed program output measures and carefully-analyzed trends in service delivery needs and available technology.

### **5.3. Capital Budget**

The current capital budgeting process is dependent to a large extent on central government policies and decisions. Municipalities propose capital projects to the Ministry of Finance; the MOF makes a selection from the list of projects and gives the municipality a "subsidy" to cover the cost of construction. Funds are allocated on a project-by-project basis; the MOF

passes on each project. While funds may be reallocated within projects, this requires MOF approval. Given the difficult economic conditions at present, it is not surprising that only a fraction of the funds requested have been forthcoming. At one extreme a municipality requested 170 million BGL and only received 23 million levs.

One major type of capital project is the extension of utility lines (water, sewer, gas, electric) into new service areas; these are done on an annual basis as funding permits. These are considered routine, although the resulting revenues do not pay back the capital investment the municipality must make for construction. Another major type of capital investment is for projects which benefit the public at large, such as hospitals and wastewater treatment plants.

It would be useful to identify the routine capital expenditure history in one municipality and cost out the appropriate user fee structure necessary for the repayment of the capital expense and for the operation of the utility, showing all direct and indirect costs. An investigation should be made of the system-wide cost of annual upgrades or extensions, showing how a surcharge on all users of the utility could pay for each incremental increase in service. This would show the true relationship between cost of service and appropriate fee structure.

Of specific interest is the user fee system for water and for wastewater treatment environmental utilities, in the event that legislation will soon permit municipalities to operate their own utilities. The current practice is that municipalities construct the facilities and turn them over to the state for operation and maintenance and collection of user fees. Information should be developed which plots a break even operating budget for a major utility, and provides differing methods for financing all the factors that comprise an operation which is kept current in its technology and plant condition. Included in the analysis would be a demonstration of the advantages of debt financing and the ways in which interest costs and the time value of money are treated in depreciation schedules.

Indications are that in the past there was a bias in favor of planning and starting projects rather than completing them. Many capital projects were started, but funds were inadequate to complete the projects in a timely fashion. Projects are in a state of construction over many years. This

combined with falling revenue to municipalities has resulted in a capital budget which is mainly composed of very old projects to be completed. The overwhelming majority of projects in the three cities the team studied were begun before 1990. Municipalities are trying to complete projects planned and started years earlier. Many of the expenditures are being used just to maintain the projects in place while awaiting adequate funds to complete them. Stretching out the project completion during periods of inflation is not cost effective, and the risk of continuing obsolete projects is increased, if abandoning the project is not evaluated as an option. There is little incentive to plan and build facilities efficiently and on a timely basis other than some amorphous feeling that the public good is being served by providing some service which promotes public health or welfare. And there is difficulty in deciding which projects to fund to completion and which ones to put into a "state of conservation."

The team identified the need to create a technical assistance and training program for capital budget preparation. Capital project planning needs to be integrated with financial planning to avoid circumstances that create incomplete projects due to lack of funds. The concept of a capital improvement plan needs to be introduced and established. The CIP, as a multi-year financing and physical facility plan, forms the basis of the capital budget. The interrelationship between physical and fiscal requirements needs to be a basic element of the capital budgeting process. In addition, the capital budget technical assistance program will facilitate the selection of capital projects from a pool of alternatives, the determination of the timing of expenditures and the means to finance them, and the effect of the change in capital stock on a local government's finances.

#### **5.4. Cash Management System**

Currently, cash management techniques employed by local governments in Bulgaria are not consistent with generally accepted cash management practices. For example, delaying processing of payable invoices and waiting for deposits to accrue can cause serious problems. The lack of cash management systems and viable credit markets for short-term borrowing and investments causes the majority of cash management problems.

The cash management technical assistance program should focus on creating technical expertise at the local government level to ensure that local governments can monitor their liquidity by providing estimates of the amount of cash on hand available for timely disbursement. This will provide an additional analytical tool, objective in nature, that can be used to assist in the preparation of annual budgets. Another goal of an effective cash management system is that it should encourage the use of "what if" analysis to assist officials in performing policy analysis. The cash management system needs to incorporate and facilitate the sizing and timing of short-term borrowing that local governments require due to the cyclical nature of their cash flows.

Finally, the cash management system should be able to provide advance warning of impending problems with the annual fiscal budget through the identification of revenue shortfalls or unexpectedly large disbursements and promote better government responsiveness and accountability.

### **5.5. Cost of Service Analysis**

The examination of current mechanisms for setting the levels of fees and charges revealed that there is no relation between fees and charges and the cost of providing services or citizens' ability to pay. This program proposes the development of criteria for calculating fee levels and establishing monitoring mechanisms to ensure compliance with legislative and administrative rules. It will also provide methods for differentiating between social services (recreation, infant care, etc.) and individual benefit services (issuance of building permits, leasing of public space for commercial purposes, etc.). The former class of services typically has fees and charges calculated based on a citizen's ability to pay. The latter type of service should have charges calculated on the basis of the cost of providing the service. The program would also require the development of a manual describing the process and workshops for municipal employees involved in providing municipal services associated with fees and charges and employees administering fees and charges.

At present, fees for services are almost entirely controlled and set by the central government, have neither risen with inflation nor been calculated with consideration for localized cost variations. The result is that

municipal and state enterprise fees have no relationship to the cost of providing the service or regulatory activity for which they are being charged.

The most rational treatment of fees is to set their rates at the break even level. That is, for basic services such as building permit issuance, the fee should pay for the labor, supplies, and overhead that go into the field work and the document preparation necessary for the issuance of a permit to construct, renovate, or demolish a building. This "pay as you go" system works in jurisdictions where there are not great fluctuations in building activity, or where administrators can lower fixed costs when building activity drops off.

Officials interviewed for this project expressed an interest in having a cost of service study done for the array of typical services and activities for which municipalities now receive fees, although in minor amounts. The intent would be to determine whether charging fees at the break even point would turn this minor source of revenue into a significant, or perhaps even major source. Moreover, carrying out this study, in cooperation with the MOF, would serve as a practical introduction to the concepts of break even financing and of charging only the user, and not the entire public, for certain elective services.

Fee calculations for utility services run into more complex variables. Not only must the fee cover the direct and indirect costs of operation and maintenance of the utility, but it must cover the capital cost and the depreciation cost of the utility in the absence of any outright grants to the utility from outside sources. And to avoid short-term deficits, the fee should include an amount for a reserve fund to cover emergencies and revenue shortfalls caused primarily by the loss of large industrial customers either through non-payment or plant closings.

## **5.6. Health Care System Analysis**

Municipal officials in Bourgas recognize the need to coordinate the medical services provided by the regional hospital, the military hospital, and the Ministry of Transportation's hospital. Of the three facilities only the regional hospital is under the municipality's budget, yet a great



opportunity will exist for coordinating the three staffs, the three facilities, and the types and levels of services to be provided when the regional hospital's new facilities are completed in 1995.

A long-term need exists for management assistance to Bourgas as it takes the lead in providing medical services based upon the volume and type of need for services of the population the municipality must serve by law. The short-term project to install and use software for developing reliable cost and care information will establish a reliable database for presenting to the Ministry of Health a supportable argument for combining facilities (perhaps with the recommendation to close the Ministry of Transportation's hospital).

A reliable cost of service database and an analysis of the equipment, facilities, and staff capabilities of each hospital will enable decision-makers at the ministry level to consider new methods for establishing norms for staffing and the number of beds per hospital. Demographic sampling methods exist for measuring medical service needs for the general population served by the regional hospital and the specific populations served by the military hospital and the Ministry of Transportation's hospital. Methods exist for measuring the efficiency of equipment usage and the optimum occupancy rates for beds in the various wards of the hospitals.

Medical care and hospital administration experts could be placed on site to assist in optimizing the use of the three facilities, and to recommend future criteria for developing budgets which responsively staff the remaining facilities, however configured. In addition, as private medical practices are developed on a broad scale, assistance should be provided to determine how equipment and facilities owned by the municipality could be shared with private practitioners on a fee basis, perhaps adding significantly to municipal revenues over time.

Medical administrators in Bourgas are aggressively attempting to cut costs by reducing the length of stay of patients and controlling the dispensing of medication in the specialized wards, among other measures. They are fully aware, however, that the greatest cost factors over which they must have control are the number and proper deployment of staff. As

the Ministry of Health currently exerts great control over the number of doctors, nurses, and support staff, new ways must be found to ensure that each office and function within the facility has the most economical and effective assignment of staff, both in number and in job type.

While there are strong inhibitions against laying off doctors, nurses, and other medical staff, or even instituting hiring freezes, medical administrators know that in the long run the medical workforce will have to be "rightsized" in order to prevent shortages in the non-salary accounts, including prescription medicine and outpatient care.

A complete job classification and pay plan is proposed for Blagoevgrad's regional hospital, to identify the nature of each position currently filled and to project staffing needs for the future based on the following assumptions:

1. that norms for hiring will be revised by the Ministry of Health to take into account the actual population being served, and not simply the census figure for the municipality and its surrounding region,

2. that the norms will be based in part upon the medical demographics of the population served; for example, those working in heavy industry, those susceptible to lung disease (smokers and the indigent), number of seasonal residents, and percentage of elderly residents,

3. that those services being provided by private practitioners have been identified and factored into the planning for levels of service to be provided by the regional hospital, and;

4. that a working relationship has been established with the medical unions (through participation of the municipal government in collective bargaining via the Ministry of Health) to define the degree to which regional hospitals will have the ability to alter workforce size and composition without approval from a higher authority.

A second long-term effort will take place in the area of accounting and financial control. A primary problem which exists for regional hospitals is

their inability to account for non-resident patients and to bill the municipalities of those patients for services rendered. At present the Constitution guarantees free medical care, and patients will gravitate toward certain regional hospitals for specialized care. The patients cannot be billed, and some regional hospitals suffer excess losses as a result. The law at present does not provide for billing other municipalities, and so certain legal and procedural changes need to be instituted for regional hospitals to recover losses in this way.

### **5.7. Service Delivery Analysis**

For this program, the team proposes a study to determine benchmarks for evaluating delivery of municipal services. This study would require the identification of two or three services identified with local government management (i.e., education, street maintenance) and the establishment of performance measures and criteria. The purpose of the study will be the creation of methodology that will provide local government policy makers and administrators with a concrete mechanism for making resource allocation decisions.

An area where service delivery analysis may produce immediate results is human resource allocation and the overstaffing problem today in some departments of local government. This is due in part to the lack of office automation, and also the absence of an incentive to consolidate and coordinate the numerous cost centers. This area lends itself well to analysis, and some staffing economies might be realized if the political will is there. At the least a computerization needs analysis could be done. The municipality now has only minimal or rudimentary database management in place.

Another possibility is in the area of privatization, where many staff are involved at this time in managing the vast array of municipal enterprises and properties. As the municipalities succeeds in divesting itself of the bulk of this property, the need for management staff will diminish accordingly. As the administration downsizes, the staff who remain to manage the retained properties and enterprises will need to be highly competent and profit-oriented.

This area is rich for analysis, with possibilities for recommending significant economies in staffing and operations. For example, as the agricultural sector is privatized, the office that plans crop production levels and livestock husbandry, as well as performing inspections for farm hygiene, etc., will lose its rationale for existing. Moreover, agriculture takes place in the outlying settlements of the municipalities, and citizens of the municipality might see the benefits of bringing more resources to bear on urban problems as outlying agricultural enterprises become more attuned to the laws of supply and demand.

## **5.8. Democratization and Citizen Participation Programs**

Local self-government in Bulgaria appears to consist of 1) a citizenry with basic civil rights, including the vote, 2) municipal councils with many minor powers and no fiscal autonomy, and 3) charismatic mayors who survive by their wits in a system of ambiguous laws concerning their powers and the councils. Combined with no history of inquiry into the workings of government, no recent expertise on the part of citizens in issues management, and destructive partisanship at both levels of government, local self-government in the true sense seems decades away. The techniques of political transparency and encouragement for citizens to participate are well known outside Central and Eastern Europe (CEE). One reason not many of those techniques are being used in Bulgaria is that citizens perceive government as being in a dangerous mode of retrenchment in these hard economic and political times. This means that politicians may, if necessary to balance the budget, take away the "free" services people had enjoyed under socialism and still have today. Thus there is a tendency for citizens not to become too strident about their cause in such circumstances lest they lose even more of the services they have taken for granted for so long.

Another reason that citizen participation is not flourishing is that mayors must cater to the agendas of political parties, and they have not mastered the technique of appearing to satisfy all of the people some of the time. That is, where some mayors have set up unstructured citizen visiting hours, for example, they are deluged by organized party groups with very specific (and often unreasonable) demands, or by individuals with requests for services that available funds cannot support. Mayors become

discouraged and sometimes estranged from the hostile groups and individuals they see as the "public."

For citizen participation to take root, mayors and councils should see the "public" as a resource and not a full-time enemy. To bring citizens into the process and to keep them interested, they must be given definable tasks and goals that are capable of being met through collective action. Win-win situations are not as easily accepted in CEE as in some other places, and so the tendency is for mayors and councils not to delegate powers to citizens as individuals or organized groups. Letting citizens "win" is often considered a "loss" to the politician.

One exception to this is the use of standing committees of municipal councils--in some CEE countries those committees are comprised in part of private citizens. The extent to which these are used, and their composition, should be closely examined in Bulgaria, and impediments to their use removed wherever possible.

Secondly, the use of *ad hoc* committees in some CEE countries has been widespread, to good effect. Progressive mayors see the trend toward citizen participation increasing greatly in the long run, and are using *ad hoc* groups of experts and specialists to solve problems in quasi-democratic settings. Where not specifically prohibited by law, such appointed committees of experts should be formed and encouraged to study discrete problems of a technical or cultural nature and recommend solutions to the mayor and council. As minor win-win victories pile up, councilors and mayors may see that managed citizen participation, in which critics are made part of the "solution," sometimes make seemingly intractable problems disappear. This approach of course calls for a change in attitude on the part of sometimes autocratic mayors and councilors, but the alternative is continued strife. Those officials will need to see that it is to their advantage to spend more time managing volunteers and less time stonewalling the issues they have not been able to bring to closure.

Programs designed to increase citizen activism will be slow in taking hold from the bottom up, so it may be best to use the powers of the office of the mayor and councilors to make progress from the top down. Technical assistance could be in the form of public relations training in

such areas as dealing with the press, making effective presentations and managing forums, delegating to volunteers, and making documents and regulations more available to, and readable by, the public.

If, for example, citizens believe that the processing of permits and documents in general is being done fairly and without corruption (which is often not the case), they will have more faith in the governmental system. Mayors and administrators, then, have to choose areas where they will take a hard stand against corruption and incompetence, clean up those operations by instituting due process and reasonable treatment of applicants, and then make the whole process as public as possible. Building departments in general in Bulgaria have immense credibility problems because of favoritism and other forms of corruption, and therefore are ripe for reform.

Examining the construction of Bulgarian law and making some statutes more permissive might help greatly with transparency and openness. Where something is not specifically provided for in a statute or the Constitution, it is not done. A survey of laws pertaining to municipal accounting and budgeting practices may show where some liberalization could be effected, perhaps in the form of preambles to statutes pertaining to billing practices of municipal entities, the establishment or abolition of municipal enterprises, and contracting out for services or personnel. Similarly, statutes pertaining to open meetings should be examined for language which unduly limits citizen participation. For example, if there is no law which prohibits citizens from examining minutes of executive council meetings, does that mean that they may not because there is no law that specifically says they may examine them?

A major approach to instituting some of the major techniques for increasing citizen participation in debates on municipal issues, and generally increasing the public's knowledge of municipal operations and decision-making processes, would be the encouragement of non-governmental, non-partisan organizations to monitor the workings of government on an informal basis, to sponsor forums, and to receive and pass on information about those techniques. For example, local "green groups" in other CEE countries have formed task forces aimed at solving specific pollution problems, and they have convened meetings of

government officials from both levels of government, volunteer consultants, and citizens at large. These groups benefit from outside funding to carry out training in information dissemination and issues management.

## **6. CAPITAL INVESTMENT ISSUES/OPPORTUNITIES**

The purpose of the inquiry was to identify potential pre-feasibility investment projects in Rousse, Bourgas, and Blagoevgrad. As part of this study, the team considered both the revenue and expenditure side of municipal budgets, as well as capital projects which may be of interest to donor institutions such as the World Bank or possibly private investors. Current practice with respect to capital budgeting reflects the transition from the former non-market era to a market economy. As such, many of the practices are evolving, and the institutions are not fully compatible with the goals and needs of municipal governments. The most clear-cut example is water supply and wastewater treatment.

The current system has evolved from the pre-1989 situation when municipalities had greater control over tax revenues. Fees for services were less important as potential mechanisms for raising money and to promote conservation. There are at present 44 water companies in Bulgaria. The original 26 regional water districts were privatized with 51% central government ownership and 49% municipal ownership, and 18 municipal companies were created from parts of the original 26. The important aspect of the current arrangement is that municipalities are responsible for making the capital investment necessary to build new water and sewer systems, but the operation is under the water supply company. The fees are set by the company and are paid to them. Preliminary results indicate that the fees for water are inadequate to cover maintenance and replacement costs of the existing infrastructure and certainly not adequate to cover service expansion. Only 10 companies were reported to have made a profit last year, and that may be an erroneous figure, depending upon how depreciation was accounted for in the calculation of profit.

This decoupling of responsibilities for capital investment and operation/pricing exists for other services such as transportation and electric service. The only area where the municipalities have control over both the capital budgeting and the operation and pricing is in the area of municipal solid waste. At present these projects may be the only ones which could be undertaken without institutional changes. Some municipalities have privatized part of this functions, and cost-based pricing may support investment in this area.

In each of the three cities investment opportunities were identified. The team's focus was primarily upon environmental projects although other projects are reported if they were identified by the municipality as important infrastructure projects. Many projects which are undertaken by municipalities may have positive environmental impacts; there are funds available from the Ministry of Environment for funding specific projects. In the three cities the team studied, only one city was currently receiving funds specifically identified as environmental.

The following is a brief description of the opportunities within each city. Attached as Appendix M is a brief description of the three municipalities included in this study.

### **Rousse**

There are approximately 31 factories in Rousse, almost all state owned. They produce a broad range of products, including plastics, leather goods, ships, and agricultural machinery. The city leases about 320 properties to private business. The capital budget for 1994 is 82 million levs: 60 million subsidy from the ministry and 22 million from local sources.

The major environmental problems in Rousse are direct discharge of municipal sewage into the Danube, the current landfill for municipal solid waste which is about to reach capacity, and trans-boundary air pollution from the Romanian chemical plant located near the border. The solution to the discharge problem is a treatment plant which has been planned at an estimated cost of about one billion levs. The landfill with improved equipment may last 15 more years; then a new one will be needed. Trans-



boundary air pollution problems are not potential investment opportunities; progress has been made on this issue with Romania.

One attractive feature of the landfill is that fees for street cleaning, including use of the landfill, are collected by the city. While this may not be a large revenue source, there is no problem of overlapping jurisdictions.

Other investments which the city is interested in completing are: restoration of the fire damaged historic performing arts theater, completion of a regional hospital, and completion of a sports complex begun by a state company which has abandoned the project. The regional hospital suffers from the problem that revenues do not match the services provided, so a return on the investment would be difficult to realize. More information on feasibility, including potential private investors for the sports arena and theater, is required.

### **Recommended Projects for Further Investigation:**

A sewage treatment plant is the highest priority from the environment perspective, but the separation of function and revenue stream requires some new solutions. This project should be investigated further. Improvements to the municipal landfill should also be investigated further, particularly a transfer compaction facility.

Developing a program to help the municipality manage and liquidate its assets combined with a small business loan fund to "develop stronger tenants" for municipal properties may be an effective means of promoting economic development in the city. USAID/ICMA has a model for such a fund developed and ready for implementation in Stara Zagora.

## **Bourgas**

The economic activity in Bourgas centers around the oil refinery and the port and ship yard. The city leases 309 shops to small business, operates 2 underground parking garages, and has 17 parcels of land which it wants to develop and/or sell. There are municipal companies operating hotels,

restaurants, and department stores. The capital budget for 1994 is 90 million levs.

The major environmental problems are air and water discharges from the oil refinery, bilge water discharge from ships, water discharge from tankers, discharge of municipal sewage, emissions from space heating, and auto emissions. Controlling emissions from the port and oil refinery is outside the authority of the municipal government; however, the refineries contribute to the economic health of the city and may provide investment opportunities. The port is going to expand using private capital and as part of the expansion will be required to install a wastewater treatment plant to handle bilge and sewage discharges from ships in the port. The plant could be located and designed to handle water from tanker cleaning as well. It should be noted that the port of Bourgas is located in a different place from the oil terminal for the refinery.

The refinery paid about 17 million levs last year in fines and fees, 11 million of it for spills. The city receives only a small portion of this, with the majority going to the central government. In addition to the discharges into the water from the refinery and ships servicing it, a major concern of the municipality is discharges into the air of aromatic hydrocarbons, some of which are carcinogenic. A mechanism which would bring the port, the city, and the refinery together to solve these problems would be desirable. A loan to improve these facilities may be an effective catalyst.

There is a housing area of about 67,000 people which is cut off from the rest of the city by an industrial area; this housing area does not have a sewage treatment plant or district heating. A sewage treatment plant has been discussed with Lemna (a U.S. firm), and the mayor is interested in looking more closely at a co-generation facility which would burn refinery sludge and municipal waste. The cooperation of the refinery would be critical.

Improvement to the existing sewer system and extending water supply to neighboring towns are important. These projects, however, suffer from the separation of function and revenue generation between the municipality and the water company described above.

In the area of solid waste the existing landfill was well designed and constructed; it may provide an opportunity for bio-gas recovery and power generation from the recovered methane. In addition, cost savings may be realized by transfer stations in the city to sort municipal waste and compact it for transfer to the landfill. In combination with the transfer station a fleet of more efficient vehicles could further reduce cost.

Outside of the issues associated with the refinery, improvements in air emissions can be realized by expansion of district heating in the city, conversion of existing heating plants to gas, and an inspection and maintenance program for vehicles in the city. Gas conversion may prove to be a viable project for a private sector company. The inspection and maintenance program could be financed through fees.

#### **Recommended Projects for Further Investigation:**

A program which would encourage the port, the refinery, and the municipality to cooperate on projects that solve environmental problems common to all should be investigated. This may mean loans contingent on cooperation or using leverage so that expansion plans include solutions to the common problems. Areas of cooperation to be investigated include: water discharge from ships and shore installations, disposal of refinery sludge, and monitoring of air emission.

A more in-depth investigation of the housing area needs for a sewer treatment plant and the co-generation possibilities, using refinery sludge and solid waste, should proceed.

Improvement in solid waste management including transfer stations, improved vehicle fleets, and bio-gas recovery at the landfill should be investigated.

The city is interested in going beyond the most common solution for vehicle emissions, electric trolley busses, to consider traffic management and vehicle inspection. The needs of the program and possible assistance should be evaluated.

The water supply issues are critical enough in the city that water rationing has been proposed. The need to overcome the obstacles set up by the combined responsibilities of the city and regional water company should be investigated, and a team should try to fashion a new solution in this area as a demonstration project. How this might fit in with the World Bank loan to the water sector needs to be investigated.

### **Blagoevgrad**

The capital budget for 1994 is 23 million leva from central government subsidy and 6 million leva from local sources. The city does not have a strong industrial base, and most enterprises are small. There are 12 municipally owned enterprises, and all but one are losing money. The city wants to improve the tourist base by developing some recreation areas it owns.

The major environmental problems facing Blagoevgrad are: the current landfill is contaminating the Strouma River; domestic space heating, which takes place in each house, is causing deterioration in air quality; municipal sewage goes directly into the river; and needs exist to acquire electric trolley busses (now that the overhead lines are almost completed) and monitoring equipment for vehicle testing.

The present landfill is located in an area of recharge for groundwater, which then flows into the Strouma River. The landfill has been operating for 20 years and is close to capacity; improper closure could result in continued contamination of the river. A site for a new landfill has been identified, and preliminary discussions have been held with a German firm regarding construction. The city has privatized part of the "street cleaning" function, which includes waste pick-up and park maintenance. Because of labor protest the new private company was forced to hire one half of the old work force; the other half remained with the municipal company. Cost savings were not fully realized.

Municipal sewage is discharged directly into the Bistritsa River, which in turn flows into the Strouma. The combined population which should be served by the plant is 80 to 100 thousand people; a number of large agricultural facilities could also be served.

Improved air quality should be achieved when the electric trolley busses are placed in service. The overhead lines are 60% to 70% completed, but there has been no subsidy for the busses. Converting present space heating to gas would reduce emissions, also improving air quality. The BULSOFGAZ company has made a preferability study of gas conversion in the city. There is an existing gas trunk pipe line in the area. Absent gas conversion, converting the city to district heating may be an option. A third air quality project is to provide monitoring equipment for the local municipal environmental authority. Mobile equipment to monitor vehicles and mandatory repair of large polluters or a "green tag" program could be used to reduce vehicle emissions. Only vehicles which meet standards would get a green decal for the windshield, and only cars with decals would be allowed to drive in the center of the city or other restricted zones. This concept was also discussed in Bourgas, and they are considering its implementation.

In the areas not directly related to environment there were two additional projects identified: power generation from the city water supply coming from the mountains and a tourism project along the Strouma River on municipal land. The city receives part of its water from the mountains through an existing pipe. The vertical drop is about 1,000 meters, and flow rates in peak periods (April-August) are about 350 to 500 liters per second and in low flow periods as low as 30 to 50 liters per second. A preliminary study suggested a number of small plants totaling 6 MW and an estimated total annual output of 30 to 50 million kilowatt hours. Local rates per kilowatt hour are 0.88 BGL during the day and 0.6 BGL at night for residential use; 1.5 BGL for commercial use at any time. The estimated cost for the projects is four million U.S. dollars.

A section of the river has been dredged in the past to a depth of 18 to 20 meters. The municipality owns 20 acres in this area and has considered developing the land for recreation. In addition the municipality owns another 20 acres in a local ski area. This land could be used in a joint venture with a private company or leased for development.

**Recommended Projects for Further Investigation:**

A further evaluation of the two potentially commercial projects--the conversion of space heat to gas and the small scale hydro project--is advisable. These may be commercially viable or at least able to be developed under current institutional constraints.

A program to help the municipality develop small enterprises, restructure current municipal companies to make them profitable, and better manage existing assets would seem appropriate. KPMG has a program to assist in privatization, but this type of program would complement theirs. This was the consensus of the municipal officials the team spoke to, since they suggested the program.

Revenue potential and approximate cost of a new landfill should be determined to see if this is feasible.